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In The

Supreme Court of the United States

CIRCUIT CITY STORES, INC.,

Petitioner,

v.

ROBERT GENTRY,

Respondent.

On Petition For Writ Of Certiorari To The Supreme Court Of California

BRIEF IN OPPOSITION

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INTRODUCTION

Circuit City's petition for writ of certiorari does not comply with the requirement of Supreme Court Rule 14(1)(g) that a petitioner must state "when the federal questions sought to be reviewed were raised, the method or manner of raising them, and the way in which they were passed on by those courts." Circuit City *cannot* comply with this rule because it did not raise either of its Questions Presented in the California courts. Neither should be considered by this Court.

Section 2 of the Federal Arbitration Act ("FAA"), which is its preemption provision, states that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Circuit City argued below that a state law rule invalidating its contractual class arbitration ban would be preempted by the FAA because such a rule would discriminate against *arbitration clauses only.* Indeed in the California Supreme Court, Circuit City's preemption argument was much narrower; it asserted that if the Supreme Court held that class action bans in wage and hour cases were always or presumptively invalid, such a bright-line rule would be preempted. The California high court rejected any across-the-board rule, opting instead for a case-by-case approach in which a given plaintiff must prove that a particular class action ban is exculpatory under the facts of the specific case.

In this Court, Circuit City now asserts new and significantly different preemption claims that the California courts never had an opportunity to address. In its first Question Presented, Circuit City focuses on the last two words in FAA § 2 – "any contract" – and contends that the decision below violates the FAA because its rationale is based on state labor policies that do not apply generally to "any contract." In its second Question Presented, Circuit City argues that the California Supreme Court's procedural unconscionability analysis improperly discriminates against arbitration because it imposes a unique requirement that arbitration agreements must expressly compare the relative "disadvantages" of arbitration to the "advantages" of litigation.

Circuit City's failure to raise these issues below, where they could have been thoroughly litigated, is compounded by its strategy in this Court of mischaracterizing the reasoning of the decision below in an effort to create conflicts with decisions of the federal circuit courts and this Court. In reality, such conflicts do not exist, further undercutting any claim for a grant of review.

The first Question Presented is based on a handful of federal circuit decisions involving state statutes or cases that affect only contracts in a single industry. Because of the narrowness of the state laws, the circuit courts held that they did not apply to "any contract" and were thus preempted by the FAA. However, the California Supreme Court's analysis

applies to *all* contracts that effectively bar individuals from vindicating rights under remedial statutes, thus causing a waiver of unwaivable rights. The governing principle is codified in California Civil Code § 1668, which provides, "*All contracts* which have for their object, directly or indirectly to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." Ital. added. *See* Pet. App. 7a-8a. Circuit City's characterization of this generally applicable principle of California contract law as being limited to "state labor law policies" is plainly inaccurate.

In its second Question Presented, Circuit City claims that the California Supreme Court's ruling on procedural unconscionability conflicts with this Court's decisions on arbitration neutrality by requiring an arbitration-specific notice concerning the disadvantages of arbitration as compared to litigation. Once again, Circuit City has seriously misread the decision below. The California Court did not impose a notice requirement solely on arbitration agreements. Rather it held that procedural unconscionability was implicated *in this case* because Circuit City deceived its employees into not opting out of arbitration by touting the theoretical benefits of arbitration while concealing the many ways in which its particular arbitration rules actually strip employees of important statutory rights. Many California decisions apply the same reasoning to

non-arbitration contracts that deprive individuals of such rights.

Finally, Circuit City's contention that the decision below conflicts with a Third Circuit case, *Gay v. CreditInform*, ___ F.3d ___, 2007 WL 4410362 (3d Cir. Dec. 19, 2007), also provides no basis for a grant of review. In *Gay*, the Third Circuit dealt with unique Pennsylvania law that "obvious[ly]" applied unconscionability differently to arbitration agreements than to non-arbitration agreements. *Id.* at *21. That is not true of the decision below. California courts have struck as unconscionable class action bans that were contained in contracts that did not involve arbitration.

This Petition for Certiorari should also be rejected for lack of a final judgment under 28 U.S.C. § 1257(a). The California Supreme Court did not deny Circuit City's petition to compel arbitration. Instead, it remanded to the trial court for fact-finding as to whether petitioner's class arbitration ban is actually exculpatory. Pet. App. 29a, 41a. Thus there has been no final determination of any federal question. By asking this Court to review the case at this stage, petitioner not only seeks to avoid the jurisdictional "final judgment" requirement but also implicitly asserts that *it does not matter what the facts are* because federal law *requires* that Circuit City be allowed to misuse arbitration to deprive individuals

of substantive statutory rights. This Court should reject petitioner's unsupported and extreme position.

STATEMENT OF THE CASE

A. Gentry's Class Action Suit and Circuit City's Arbitration Agreement

Robert Gentry was employed as a customer service manager for Circuit City Stores, Inc. In August 2002, he filed a class action against Circuit City. The suit alleged that Circuit City was violating California statutes and wage orders by failing to pay overtime compensation to its customer service managers, who were wrongfully classified as "exempt" employees. Cal. S. Ct. Exhibits in Support of Petition for Writ of Mandate and/or Prohibition ("Cal. Exhs.") 1-15. In support of the class action remedy, the complaint alleged that the claims of the individual class members were not sufficiently large to warrant vigorous prosecution and that if each employee were required to file an individual lawsuit, Circuit City would gain an unconscionable advantage because of its vastly superior resources. *Id.* 9. The complaint also alleged that, without class actions, many employees would not pursue their rights because of their "real and justifiable fear of retaliation." *Ibid.*

Circuit City petitioned to compel arbitration of Gentry's individual claims and to dismiss the lawsuit. It alleged that Gentry had entered into an agreement

in which he agreed to submit all employment-related claims to arbitration. *Id.* 16-71. Circuit City did not claim that Gentry had actually signed an arbitration agreement. Instead, it argued that in March 1995 Gentry had failed to send in a form that would have allowed him to opt out of its arbitration program and thus he was bound to the agreement by his inaction. *Id.* 31-38.

The arbitration materials that Circuit City gave to Gentry and other employees in March 1995 strongly encouraged them *not* to opt out and concealed that Circuit City's 1995 arbitration rules drastically limited substantive rights guaranteed by California law. The Circuit City handbook proclaimed: "WHY ARBITRATION IS RIGHT FOR YOU AND CIRCUIT CITY" and set forth general statements about the benefits of arbitration. Cal. Exhs. 46. The handbook did *not* inform employees that Circuit City's arbitration program stripped workers of the following legal rights. Pet. App. 37a.

- Circuit City's arbitration rules restricted employees to one year of back pay from the point the employee knew or should have known of the legal violation. Cal. Exhs. 59. Under California law, an employee can recover back pay for a three-year or four-year period from the date the cause of action accrued. Cal. Code Civ. Proc. § 338; Cal. Bus. & Prof. Code § 17208; *Cortez v. Purolator Air Filtration Products Co.*, 23 Cal.4th 163, 168, 178-179 (2000).

- Circuit City's arbitration rules imposed a one-year statute of limitation on all claims. Cal. Exhs. 59. California law provides a three-year statute of limitations for recovering overtime wages (Cal. Code Civ. Proc. § 338) and a four-year statute for an unfair competition claim. Bus. & Prof. Code § 17208.

- Circuit City's arbitration rules placed the burden of proof on the employee in all instances. Cal. Exhs. 56. Under California law (as under the Fair Labor Standards Act, 29 U.S.C. § 201 *et seq.*), the employer has the burden to prove that an employee is exempt and thus ineligible for overtime pay. *Ramirez v. Yosemite Water Co.*, 20 Cal.4th 785, 794-795 (1999); *Corning Glass Works v. Brennan*, 417 U.S. 188, 196-197 (1974).

- Circuit City's arbitration rules provided that parties will "generally" be liable for their own attorney fees, with the arbitrator having "discretion" to award fees to a prevailing employee. Cal. Exhs. 59. Under California law, a prevailing employee in an overtime case is "entitled" to recover reasonable attorney fees and costs. Cal. Lab. Code § 1194(a).

- Circuit City's arbitration rules prohibited all class actions and even the consolidation of different employees' claims. Cal. Exhs. 57. California law permits

> consolidation of claims and class actions where appropriate.[1]

Over Gentry's objections, the trial court granted Circuit City's petition to compel arbitration and ordered Gentry to arbitrate his claims individually. Pet. App. 75a. Gentry's petition for writ of mandate to the California Court of Appeal was summarily denied. *Id.* 68a. The California Supreme Court granted review and deferred action pending its decision in *Discover Bank v. Superior Court*, a consumer case involving a form arbitration agreement prohibiting class actions. After its decision in *Discover Bank*, 36 Cal.4th 148 (2005), the California Supreme Court in August 2005 remanded this case to the Court of Appeal with directions "to vacate its decision and to reconsider the cause in light of *Discover Bank*." Pet. App. 4a, 67a. On remand, the Court of Appeal ruled that Circuit City's class action prohibition was not substantively unconscionable under *Discover Bank* and was not procedurally unconscionable because of the opt-out provision. *Id.* 5a, 56a-66a. The California Supreme Court again granted review.

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[1] Circuit City's arbitration rules imposed other one-sided or highly restrictive provisions. Employees were required to arbitrate but the company was free to go to court. Cal. Exhs. 52. Circuit City had the unilateral right to modify the arbitration rules every year. *Id.* 60. Front pay was available only in "rare" cases, for a maximum of 24 months, and punitive damages were limited to $5000. *Id.* 59.

B. The California Supreme Court's Decision

1. The Class Arbitration Ban

The California Supreme Court reversed and remanded for further proceedings. The Court reasoned as follows. Gentry's lawsuit was filed pursuant to California Labor Code § 1194, which provides an unwaivable private right of action to enforce violations of California's overtime laws. Employees' rights to timely payment of overtime are rooted in the important public policy of protecting the health and welfare of the workers themselves as well as the general health and welfare. Pet. App. 11a. Even though a party may be compelled to arbitrate such statutory rights and thus to "submit[ ] to their resolution in an arbitral, rather than a judicial, forum," the arbitration rules cannot be used to accomplish a de facto, exculpatory waiver of these rights. *Little v. Auto Stiegler, Inc.*, 29 Cal.4th 1064 (2003), quoting *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991); Pet. App. 12a.

"Under *some* circumstances," the Court reasoned, a class arbitration ban would cause a de facto waiver of statutory rights and would impermissibly interfere with employees' ability to enforce the overtime laws, just as such waivers in some consumer cases are unconscionable and unenforceable where they make it unduly difficult for affected consumers to pursue legal remedies. *See Discover Bank v. Superior Court*, *supra*, 36 Cal.4th 148; Pet. App. 13a, ital. added. Class action prohibitions in wage and hour cases may

have such an exculpatory effect under California law for several reasons.

First, awards in wage cases tend to be modest, making it less likely that many employees will bring individual actions. *Id.* 13a-14a. Second, a current employee will hesitate to bring an individual action against his or her employer because of the risk of retaliation. *Id.* 17a-19a, citing *Mitchell v. Robert DeMario Jewelry, Inc.*, 361 U.S. 288, 292 (1960) ("[I]t needs no argument to show that fear of economic retaliation might often operate to induce aggrieved employees quietly to accept substandard conditions."). Third, some individual employees will not pursue their legal rights because they are unaware the rights have been violated, especially where, as alleged here, the employer affirmatively tells its employees they are not eligible for overtime. *Id.* 20a. These problems may be reduced by class actions, in which workers band together to assert their rights. *Id.* 21a-23a.

The Court emphasized that not all class arbitration prohibitions in overtime cases are unenforceable and that a trial court must evaluate their exculpatory impact on a case-by-case basis, determining on the facts of each case whether the ban interferes with enforcement of unwaivable statutory rights. Pet. App. 22a-23a. The Court remanded the case to enable the trial court to decide the validity of Circuit City's class ban under these guidelines. The Court noted that if the ban were invalidated, the parties would proceed to class arbitration (if the class was certified), unless they stipulated to have the matter heard in court or

unless the entire arbitration agreement was held unconscionable because of its other allegedly unconscionable terms, which Gentry timely challenged but the California Supreme Court did not reach. *Id.* 29a. Thus, under the Court's decision, invalidating a class arbitration ban leaves the parties in an arbitration forum, not in court. *Id.* 25a.

2. FAA Preemption

The California Court rejected Circuit City's argument that a rule invalidating class arbitration bans discriminates against arbitration clauses in violation of the FAA. The Court reasoned that the principle that a class action ban may be invalid where it interferes with the enforcement of unwaivable statutory rights is an "arbitration-neutral rule: it applies to class waivers in arbitration and nonarbitration provisions alike." Pet. App. 27a. Such a principle is an "application[ ] of general state law contract principles regarding the unwaivability of public rights to the unique context of arbitration, and accordingly [is] not preempted by the FAA." *Ibid.*, quoting *Little, supra,* 29 Cal.4th at 1079.

At no stage of the proceedings below did Circuit City argue that an agreement to arbitrate cannot be invalidated by state-law policies other than those that apply to "any contract." 9 U.S.C. § 2.

3. Procedural Unconscionability

The California Supreme Court reached the issue of procedural unconscionability in connection with Gentry's challenge to the validity of provisions in the Circuit City arbitration agreement *other than* the class arbitration ban. The Court rejected the lower courts' determination that there was no procedural unconscionability, which rested on Gentry's supposed right to opt out of arbitration in March 1995. The Court found that the evidence demonstrated, under longstanding California unconscionability standards, that Gentry's failure to opt out of arbitration did not represent an "authentic informed choice." Pet. App. 36a.

First, the explanation of arbitration in the Circuit City handbook was "markedly one-sided." *Ibid.* By emphasizing that arbitration was "much less expensive" and that the "arbitrator can award money damages to compensate you" without mentioning the many significant disadvantages that Circuit City had inserted into *this particular arbitration agreement* (*supra*, pp. 6-8), the handbook presented a "highly distorted picture of the arbitration Circuit City was offering." Pet. App. 38a. The legally unsophisticated employees who would be the likely plaintiffs in suits seeking overtime pay would not have understood that these rules and procedures are considerably less favorable to an employee than the rules normally available in a judicial forum. *Id.* 38a-39a.

Second, Circuit City employees would have felt pressure *not* to opt out of arbitration because the

explanatory materials Circuit City provided – including the all-caps heading "WHY ARBITRATION IS RIGHT FOR YOU AND CIRCUIT CITY" – made unmistakably clear that Circuit City strongly preferred arbitration and wanted its employees *not* to opt out. *Id.* 39a.[2]

These factors led the Court to conclude that "some degree of procedural unconscionability" was present, sufficient to potentially require judicial scrutiny of substantive unconscionability by the trial court on remand. *Id.* 40a. Under California unconscionability analysis, a sliding scale is invoked; the more substantively unconscionable contract terms are, the less evidence of procedural unconscionability is required to conclude that they are unenforceable, and vice versa. *Id.* 34a.

At no stage of the proceedings below did Circuit City argue that a finding of procedural unconscionability based on the misleading representations in petitioner's handbook would be preempted as constituting an arbitration-specific requirement that arbitration agreements must compare the relative "disadvantages" of arbitration with the "advantages" of litigation.

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[2] Although the Circuit City handbook said that employees could consult with an attorney about their legal rights, the Court found it "unrealistic" to expect anyone other than higher echelon employees to hire an attorney to review what appears to be a routine personnel document. Pet. App. 39a.

REASONS FOR DENYING THE WRIT

I. THE COURT LACKS JURISDICTION OVER THIS CASE BECAUSE THE DECISION BELOW, REMANDING FOR FURTHER PROCEEDINGS TO DETERMINE THE FEDERAL QUESTION, IS NOT A FINAL JUDGMENT UNDER 28 U.S.C. § 1257(a).

This Court has jurisdiction to review "[f]inal judgments or decrees rendered by the highest court of a State in which a decision could be had. . . . " 28 U.S.C. § 1257(a). Section 1257(a) establishes a "firm final judgment rule" in which the state court's decision is "final as an effective determination of the litigation and not of merely interlocutory or intermediate steps therein." *Jefferson v. City of Tarrant, Ala.*, 522 U.S. 75, 81 (1957). Section 1257's requirement of finality "is not one of those technicalities to be easily scorned. It is an important factor in the smooth working of our federal system." *Id.*, quoting *Radio Station WOW, Inc. v. Johnson,* 326 U.S. 120, 124 (1945). The principal exceptions to the final judgment rule apply where the federal question has been finally decided but there will be further proceedings in the lower state courts. *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975).

Here, this Court lacks jurisdiction under § 1257(a) since the California Supreme Court did not issue a final judgment or decree and did not finally determine any federal question. Instead, the Court set forth general principles, to be applied on a case-by-case basis depending on the evidence presented,

and remanded to allow for further determinations by the trial court on numerous issues, subject to further appellate review.

On remand, the trial court must make factual findings about whether, *on the facts of this case,* Circuit City's class arbitration ban is invalid because it significantly interferes with the vindication of unwaivable statutory rights of its employees. If the trial court answers yes to this question, the parties may proceed to arbitrate over the appropriateness of class certification in this case – *unless* (1) they agree to have the case heard in court after all, or (2) the trial court invalidates the arbitration agreement altogether because of its many *other* oppressive, one-sided provisions. Pet. App. 29a, 41a. In short, there has not yet been a final determination of the federal question and there are so many contingencies to be exhausted and issues to be decided that the decision of the California Supreme Court is not a final judgment under § 1257(a).

Circuit City contends that this Court has jurisdiction based on *Southland Corp. v. Keating*, 465 U.S. 1 (1984) and *Perry v. Thomas*, 482 U.S. 483 (1987). Pet. 1. Neither case controls because in both, the lower courts had rendered final decisions on the federal questions at issue. In *Southland*, the California Supreme Court had ruled that the California Franchise Investment Law guaranteed a judicial (not arbitral) forum for claims under that statute and that this requirement was not preempted by the FAA. This Court held it had jurisdiction because the California

Supreme Court had finally determined the federal issue as to these parties. *Southland Corp, supra*, 465 U.S. at 6-8. In *Perry v. Thomas,* the California courts, rejecting a claim of FAA preemption, had refused to compel arbitration of an action for wages in reliance on a California statute that guaranteed a judicial forum for wage suits. Citing *Southland*, this Court held, without discussion, that it had jurisdiction. *Perry, supra,* 482 U.S. at 489 n. 7.

Because in this matter there has been no decision of the federal question as to these parties, this case presents no basis to depart from § 1257(a)'s imposition of a "firm final judgment rule." The Court lacks jurisdiction, and the Petition must therefore be denied.

II. THIS IS NOT AN APPROPRIATE CASE FOR DECIDING THE FIRST QUESTION PRESENTED BECAUSE THAT ISSUE WAS NEVER RAISED BELOW AND NO CONFLICT EXISTS.

In its first Question Presented, Circuit City asserts that the California Supreme Court decision conflicts with several federal circuits on the question whether state-law policies other than those that apply to "any contract" may preclude enforcement of the terms of an agreement to arbitrate. 9 U.S.C. § 2; Pet. 15. This issue is not worthy of review because it was not presented below and because there is no split of authority.

A. Circuit City's First Question Presented Was Not Raised Below.

Circuit City did not present its current "any contract" argument to the California courts. To the extent it argued FAA preemption below, Circuit City contended that a rule invalidating class arbitration waivers discriminates against *arbitration clauses* in violation of the FAA. Pet. App. 26a-27a; Circuit City Brief in Cal. Supreme Court, pp. 46-52. Accordingly, the California courts did not have the opportunity to address Circuit City's new "any contract" argument.

This Court "will not consider a petitioner's federal claim unless it was either addressed by, or properly presented to, the state court that rendered the decision" under review. *Adams v. Robertson*, 520 U.S. 83, 86 (1997). In *Adams*, the Court refused to consider issues raised in the state court for the first time on a petition for rehearing. Here, where the argument was *never* raised in the state courts, there is even less reason to make it the basis for a grant of review.

B. The "Any Contract" Argument Does Not Present a Basis for Review in Any Event Because the Allegedly Conflicting Decisions Are Distinguishable.

On the merits as well, Circuit City's first question does not warrant review because the cases it cites for the alleged conflict are all distinguishable.

The principal case on which Circuit City relies is *Bradley v. Harris Research, Inc.*, 275 F.3d 884 (9th

Cir. 2001). In *Bradley*, a California statute imposed specific venue requirements on all franchise agreements (including franchise arbitration agreements) that involved businesses operating within California. The Ninth Circuit held that, because the statute applied *only* to franchise agreements – *not to contracts generally* – and had the effect of invalidating some provisions of arbitration agreements, it violated the FAA § 2.

The *Bradley* court carefully distinguished the case before it from cases in which the party opposing arbitration raised generally applicable contract defenses, such as unconscionability. *Id.* at 889-890 and n. 7, citing *Ticknor v. Choice Hotels Intern., Inc.*, 265 F.3d 931 (9th Cir. 2001). In the latter type of case, the Ninth Circuit recognized this Court's often-quoted statement in *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996) that "generally applicable contract defenses, such as fraud, duress or unconscionability, may be applied to invalidate arbitration agreements without contravening § 2." *Id.* at 687.

The four other cases cited by Circuit City are similarly distinguishable. Three involve state statutes governing contracts in a single industry (franchise, construction and beer). *KKW Enterprises, Inc. v. Gloria Jean's Gourmet Coffees Franchising Corp.*, 184 F.3d 42 (1st Cir. 1999); *OPE International LP v. Chet Morrison Contractors, Inc.*, 258 F.3d 443 (5th Cir. 2001); *Stawski Distributing Co. v. Browary Zywiec S.A.*, 349 F.3d 1023 (7th Cir. 2003). The fourth involves state case law applicable only to franchise

contracts. *Doctor's Associates, Inc. v. Hamilton*, 150 F.3d 157 (2d Cir. 1998) In each case, the court held that state law was preempted because it was limited to one type of contract.

By contrast, this case involves a "generally applicable contract defense" under California law – namely, that contract terms are invalid if they prevent individuals from effectively vindicating unwaivable statutory rights and are effectively exculpatory. *Little v. Auto Stiegler, Inc.*, *supra*, 29 Cal.4th at 1079. That defense is *not* limited to "state labor law policy," as Circuit City contends, but applies to any exculpatory contract contrary to public policy. Pet. App. 27a. This principle is codified in California Civil Code § 1668, which expressly indicates its universal application: "*All contracts* which have for their object, directly or indirectly to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law." Ital. added, *see* Pet. App. 7a-8a.

Civil Code § 1668 and the defense it codifies have been applied to many types of contracts. *E.g.*, *Discover Bank, supra*, 36 Cal.4th 148 (class arbitration prohibition in consumer credit card transaction); *Tunkl v. Regents of University of California*, 60 Cal.2d 92, 99-100 (1962) (release from liability for future negligence imposed as condition for patient's admission to charity hospital); *Gavin W. v. YMCA of Metropolitan Los Angeles*, 106 Cal.App.4th 662, 670-671 (2003) (parental release of liability involving

child-care program); *In re Marriage of Fell*, 55 Cal.App.4th 1058, 1063-1065 (1997) (waiver of disclosure by parties to a dissolution); *Baker Pacific Corp. v. Suttles*, 220 Cal.App.3d 1148, 1153-1154 (1981) (employee waiver of all employer liability for asbestos exposure); *Halliday v. Greene*, 244 Cal.App.2d 482, 488 (1966) (exculpatory waiver of safety order in residential lease).

The principle embodied in § 1668 is consistent with this Court's repeated holdings that "[b]y agreeing to arbitrate a statutory claim, a party does not forego the substantive rights afforded by the statute; it only submits to their resolution in an arbitral . . . forum." *Preston v. Ferrer*, ___ U.S. ___, 2008 WL 440670 *8 (U.S. Feb. 20, 2008); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628 (1985); *Gilmer, supra*, 500 U.S. at 26.

Thus, review of the first Question Presented should be denied because the issue was not raised below and because the alleged conflict does not exist.

III. THE SECOND QUESTION PRESENTED DOES NOT WARRANT REVIEW BECAUSE IT WAS NOT RAISED BELOW AND IS BASED ON A MISCHARACTERIZATION OF THE DECISION BELOW.

The second Question Presented is also not worthy of review. It was not presented below and it is premised on an erroneous construction of the decision below. Circuit City contends that the California

Supreme Court's analysis of procedural unconscionability created an "arbitration-specific requirement that an individual be specifically provided an explanation of the 'disadvantages' of arbitration as compared to litigation." Pet. 26. That is simply not so.

It is, of course, well established that unconscionability is a generally applicable contract defense that is *not* preempted by the FAA. 9 U.S.C. § 2; *Doctor's Associates, supra*, 517 U.S. at 687. Under California law, procedural unconscionability focuses on oppression or surprise due to unequal bargaining power and, under California's "sliding scale" analysis, the more substantive unconscionability is present, the less procedural unconscionability is required to conclude that a contract term is unenforceable. Pet. App. 34a; *Discover Bank, supra*, 36 Cal.4th at 160. In analyzing procedural unconscionability in this case, the California Supreme Court was responding to Circuit City's argument that because Gentry could have opted out of arbitration, there could be no such unconscionability. The Court concluded that the Circuit City agreement was "at the very least, not entirely free from procedural unconscionability" because there were several indications that Gentry's failure to opt out did not represent "an authentic informed choice." Pet. App. 36a, 39a-40a.

First, the Circuit City handbook's explanation of the benefits of arbitration was "markedly one-sided," which meant that the employees would receive a "highly distorted" picture of the arbitration Circuit City was offering. *Id.* 36a, 38a. The handbook touted

the *generic* benefits of arbitration but concealed the many provisions in Circuit City's *actual* arbitration program that deprived employees of statutory protections provided by California law, including the drastic limitation on damages, the significantly shorter statute of limitations, the reversal of the burden of proof, the general denial of attorneys' fees to a prevailing employee, and the class action ban. *See supra*, pp. 6-8. Additionally, employees likely felt pressure *not* to opt out of arbitration because Circuit City's published materials made it "unmistakably clear" that the company wanted its employees to participate in the arbitration program. Pet. App. 39a.

Circuit City contends that the California Supreme Court's analysis "required an additional arbitration-specific obligation to disclose every possible way in which the rules of arbitration might be deemed 'less favorable to an employee than those operating in a judicial forum.'" Pet. 26. That argument seriously misconstrues the decision below and takes the single-quoted phrase in the previous sentence out of context to make its inaccurate point. *See* Pet. App. 38a. The California court was not imposing a notice requirement only on arbitration agreements. It was simply saying that procedural unconscionability is implicated where a stronger party tricks a weaker party into being contractually bound by concealing the unfavorable terms of an agreement.

California courts regularly apply this principle to all manner of contracts. *See, e.g, Pardee Construction*

Co. v. Superior Court, 100 Cal.App.4th 1081, 1089-1090 (2002) (residential construction contract held unconscionable where oppressive provisions were not explained and were buried in form contract); *Ilkhchooyi v. Best*, 37 Cal.App.4th 395, 410 (1995) (commercial lease provision held unconscionable where profit-shifting clause was buried in small print in long paragraphs under inaccurate heading and lessor assured tenant that lease was the same as earlier one); *Ellis v. McKinnon Broadcasting Co.*, 18 Cal.App.4th 1796, 1804 (1993) (forfeiture provision in employment contract held unconscionable because it was not explained to employee); *A & M Produce Co. v. FMC Corp.*, 135 Cal.App.3d 473, 489-491 (1982) (warranty disclaimer and damage exclusion in commercial contract held unconscionable where not pointed out to weaker party).

Petitioner never raised below its current argument about the alleged preemption of this rule of procedural unconscionability even though Gentry made the procedural unconscionability argument that the California Supreme Court ultimately accepted. Gentry Opening Brief in Cal. Supreme Court, pp. 54-57. If Circuit City had made such a preemption argument, the California Court would have had the opportunity to explain that it applied the same unconscionability analysis in this case that it would have applied in any case involving a "markedly one-sided" and "highly distorted" contract description.

This case is distinguishable from the two cases Circuit City cites in an effort to establish a conflict,

Perry v. Thomas, *supra*, 482 U.S. 483 and *Doctor's Associates, Inc.*, *supra*, 517 U.S. 681. In both cases, state statutes clearly established arbitration-specific rules. In *Perry*, the statute specifically exempted wage collection actions from arbitration and guaranteed a judicial forum for such claims. In *Doctor's Associates,* the statute required contracts subject to arbitration to display a unique notice in underlined capital letters on the first page. The instant case, by contrast, involves no such arbitration-specific rule.

This case is also distinguishable from *Gay v. CreditInform*, *supra*, ___ F.3d ___, 2007 WL 4410362. Circuit City's contention that the two decisions conflict in their unconscionability analyses is incorrect. In *Gay*, the Third Circuit refused to follow Pennsylvania state court decisions that invalidated class arbitration bans as unconscionable because, according to the Third Circuit, "although written ostensibly to apply general principles of contract law," the Pennsylvania decisions "hold that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate." *Id.* at *20. In other words, the *Gay* court refused to follow Pennsylvania unconscionability analysis because it concluded that the Pennsylvania courts were treating arbitration clauses more hostilely than they would have treated similar clauses in non-arbitration agreements. The California Supreme Court's analysis, by contrast, applied the well-established, arbitration-neutral California principle that procedural unconscionability may be implicated where a weaker party is induced to enter into a

markedly unfavorable contract based on surprise or other sharp practices.[3]

The Ninth Circuit in *Lowden v. T-Mobile USA*, ___ F.3d ___, 2008 WL 170279 (9th Cir. Jan. 22, 2008) refused to follow *Gay* because it found that *Gay* dealt with unique Pennsylvania law that was in conflict with the FAA. The Ninth Circuit stated, "Unlike the Third Circuit's conclusion as to the applicable state law in *Gay*, we determine that the Washington Supreme Court in *Scott* does not hold 'that an agreement to arbitrate may be unconscionable simply because it is an agreement to arbitrate.'" *Id.* at *8 n. 3.

In the decision below, as well as many others, the California Supreme Court has shown its deference to the principle that the FAA prohibits the imposition of arbitration-specific requirements. Pet. App. 26a-27a;

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[3] We anticipate that the amici curiae supporting Circuit City may argue that *Gay* conflicts with the decision below for broader reasons – namely, the Third Circuit flatly upheld the validity of a class arbitration ban while the California Supreme Court held such a ban may be unenforceable in some cases. Besides being premature, such an argument would be wrong. *Gay* found class bans valid because the state-law arguments against them were based on hostility to arbitration. By contrast, the California Supreme Court's decision held such bans to a standard that applies both to arbitration and non-arbitration contracts. *See, America Online, Inc. v. Superior Court*, 90 Cal.App.4th 1 (2001) (choice of law provision in non-arbitration contract, which had the effect of banning class actions, held invalid), cited with approval in *Discover Bank v. Superior Court*, *supra*, 36 Cal.4th at 158-159.

Armendariz v. Foundation Health Psychcare Services, 24 Cal.4th 83, 119 (2000) ("[T]he United States Supreme Court has taught 'that a court may not rely upon anything that is unique to an agreement to arbitrate when assessing unconscionability of an agreement governed by the FAA'"); *Little, supra*, 29 Cal.4th at 1080 ("We recognize that '[i]n enacting § 2 of the [FAA], Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration'"); *Discover Bank, supra*, 36 Cal.4th at 167 ("[T]he FAA does not federalize the law of unconscionability or related contract defenses except to the extent that it forbids the use of such defenses to discriminate against arbitration clauses").

The decision below is consistent with these principles and does not warrant review.

CONCLUSION

For the foregoing reasons, the Petition for Certiorari should be denied.

Respectfully submitted,

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